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Supreme Court of the United States

OCTOBER TERM, 1977

No. 77-64

ASHLAND OIL, INC., COMMONWEALTH OIL REFINING COMPANY, INC. and PETROLEUM MARKETING CORPORATION,
Appellants,

v.

GOVERNOR OF THE STATE OF MARYLAND, *et al.*,
Appellees.

ON APPEAL FROM THE COURT OF APPEALS OF MARYLAND

JURISDICTIONAL STATEMENT

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ON APPEAL FROM THE COURT OF APPEALS OF MARYLAND

JURISDICTIONAL STATEMENT

Appellants Ashland Oil, Inc. ("Ashland"), Commonwealth Oil Refining Company, Inc. ("Commonwealth") and Petroleum Marketing Corporation ("PMC") hereby appeal from that portion of the judgment of the Court of Appeals of Maryland, entered on February 18, 1977, which denied their claim that Paragraphs B and C of the Maryland Fuel Inspection Law, as amended (the "Maryland Act"), are invalid under Article I, Section 8, of the United States Constitution.

OPINIONS BELOW

The main opinion of the Court of Appeals of Maryland, reversing the Circuit Court for Anne Arundel County, is reported at 279 Md. 410 and at 370 A.2d 1102. A sup-

plemental opinion of the Court of Appeals, denying motions for reconsideration and for a stay of judgment, is reported at 279 Md. 456. The Circuit Court for Anne Arundel County rendered two opinions, neither of which has been officially reported. These opinions are reproduced in a Joint Appendix, submitted with other appellants that have appealed from the same judgment, as Appendices A, B, C and D, respectively.[1]

JURISDICTION

The federal question presented by this appeal was raised in Appellants' bills of complaint, as filed in the Circuit Court for Anne Arundel County. (E. 302).[2] That court held that the Maryland Act was unconstitutional on a number of grounds, but ruled that it did not violate the Commerce Clause. (App. D 123a). On appeal, Appellants renewed their Commerce Clause objections to the Maryland Act. The Maryland Court of Appeals reversed the Circuit Court, holding that the Act was constitutional in all respects. In doing so, it specifically rejected Appellants' contentions respecting the Commerce Clause. (App. A 16a-24a).

The opinion of the Court of Appeals of Maryland, which constitutes its judgment, was filed and entered on February 18, 1977. Motions for reconsideration and for a stay of mandate were timely filed and were denied in a supplementary opinion filed on April 13, 1977.

Notices of appeal to this Court were filed by Ashland on July 1, 1977, and by Commonwealth and PMC on July 11, 1977, with the Clerk of the Maryland Court of Appeals and with the Clerk of the Circuit Court for Anne Arundel County.

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[1] The other appellants are Exxon Corporation, Phillips Petroleum Company, Continental Oil Company and its subsidiary Kayo Oil Company, Shell Oil Company, and Gulf Oil Corporation.

[2] "E." denotes the Joint Record Extract filed in the Court of Appeals of Maryland.

which is the court possessed of the record. Ashland's notices appear in Appendix E of the Joint Appendix. Commonwealth's and PMC's notices are reproduced at the end of this Jurisdictional Statement.

The jurisdiction of this Court is invoked under 28 U.S.C. §1257(2).

STATUTES INVOLVED

Chapter 854, Laws of Maryland 1974, was amended by Chapter 608, Laws of Maryland 1975, and codified in the Maryland Annotated Code (1957), Art. 56, §157E (1972 Repl. Vol. 1976 Cum. Supp.). These chapters ("the Act" or "the Maryland Act") added the following provisions to the Motor Fuel Inspection Law:

> (B) After July 1, 1974, no producer or refiner of petroleum products shall open a major brand, secondary brand or unbranded retail service station in the State of Maryland, and operate it with company personnel, a subsidiary company, commissioned agent, *or under a contract with any person, firm or corporation, managing a service station on a fee arrangement with the producer or refiner. The station must be operated by a retail service station dealer.*
>
> (C) After July 1, 1975, no producer or refiner of petroleum products shall operate a major brand, secondary brand, or unbranded retail service station in the State of Maryland, with company personnel, a subsidiary company, commissioned agent, *or under a contract with any person, firm or corporation managing a service station on a fee arrangement with the producer or refiner. The station must be operated by a retail service station dealer.*
>
> (The italicized provisions are those added by Chapter 608 of the Laws of 1975.)

QUESTION PRESENTED

Whether Paragraphs (B) and (C) of the Maryland Act, which would prevent independent refiner-marketers such as Ashland and Commonwealth from continuing to operate private brand, discount gasoline stations in competition with franchised major brand dealers, constitute an undue burden on and an unlawful discrimination against interstate commerce in violation of the Commerce Clause of the United States Constitution.

STATEMENT OF THE CASE

No crude oil is produced or refined in the State of Maryland. (App. A 19a). All of the petroleum products sold in Maryland are produced and refined elsewhere and transported into the State by pipeline, ship or truck. (E. 74, 91-92, 95-96, 103-04, 120, 142-43, 144, 456). Such products are purchased at retail by local consumers, by interstate travellers and by trucking companies engaged exclusively in interstate commerce. (E. 76, 107-08).

Motor vehicle fuels are sold to consumers and others at two basic types of retail establishments. The first and most prevalent type is the "major brand" service station, which sells nationally advertised brand-name products, accepts credit cards, and usually offers a full line of ancillary services, such as repairs and tire and battery sales. A less common form of retailing is the "private brand" station. These stations sell only gasoline and motor oil; they use a multitude of unadvertised trade names; they offer few, if any, other services, and do not accept credit cards. The private brand stations attract customers by offering gasoline at prices which usually are substantially lower than those posted by the major brand stations. (App. D 98a-99a). In areas where both types of station are present, the consumer has a choice; he may patronize a major brand station, to obtain greater service, or a private brand station, to obtain a lower price.

The vast majority of major brand stations are operated by dealers under franchise agreements with the oil companies that supply them. The vast majority of private brand stations are operated by salaried company personnel. (App. D 99a; E. 382-83, 488-89, 505).[3] Roughly half of the private brand stations in Maryland are operated by companies which also produce or refine crude oil. (E. 70-71). The remainder are operated by independent marketers which purchase gasoline at wholesale from refiners for direct resale to consumers. (*Id.*).

Paragraphs (B) and (C) of the Maryland Act prohibit producers and refiners[4] of petroleum products from operating retail service stations with company personnel, and provide that all such stations "must be operated by a retail service station dealer." The statute, if sustained, will have little effect on the major brand stations, most of which are operated by dealers. Its principal impact will be on the lower-priced private brand stations, at least half of which are operated by refiners.

The requirement that all company-owned stations must be operated by dealers will impose a burden on all those refiners that now operate retail service stations in Maryland with salaried company personnel. However, the statutory burden will fall most heavily on those partially-integrated,

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[3] As of July 1, 1974, there were approximately 3,780 retail service stations in Maryland, of which 3,547 were dealer-operated and only 233 were company-operated. (E. 70-71). Some of the major-brand stations were company-operated, but most were dealer-operated — *i.e.*, 596 out of 628 Exxon stations and 283 out of 284 Shell stations were dealer-operated. By contrast, all of Ashland's "Bi-Lo", "Hi-Fi", "Payless", and "Red Head" stations, and all of PMC's "Scot" stations, were company-operated. (E. 70-71). PMC is Commonwealth's wholly-owned marketing subsidiary.

[4] All of the producing companies which operate retail service stations in Maryland are refiners. For convenience, the term "refiners" will be used hereafter to include both crude oil "producers" and petroleum product "refiners".

independent refiners, such as Ashland and Commonwealth, that have traditionally sold their products through private brand, company-owned retail outlets. These companies, unlike the more fully integrated oil companies that supply the major brand stations, cannot adopt the dealer distribution method which the Maryland Act requires, and thus will be obliged to discontinue business in the State if the Act is upheld. To understand why this is so, one must understand the position of independent refiners in the national petroleum industry.

"Independent refiners" are companies that engage in the refining and marketing of petroleum products, but do not own or control a significant portion of the crude oil supplies required by their refineries. Neither do they have a controlled source of purchasers for their products, the bulk of which are sold in the wholesale market to jobbers or to independent retailers for resale to consumers.[5] They are thus distinguished from the so-called "major" oil companies, which directly own or control a large percentage of the refinery crude oil requirements and sell most of their products through franchised dealers. (E. 485, 505-06).

Historically, independent refiners have competed successfully with the majors. To do so effectively, however, they have been required to adapt to two problems which are characteristic of their position in the industry:

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[5]Ashland purchases about 85% of its crude oil requirements from domestic or foreign petroleum producers over which it has no control. (E. 144, 485). Commonwealth purchases 100% of its crude requirements from other producers. (E. 142). Approximately 60% of Ashland's refinery production is sold at wholesale to independent accounts; approximately 8% is sold to Ashland branded dealers in a small area adjacent to its main refinery at Ashland, Kentucky; the remaining 32% is sold through company-operated outlets located in the mid-West, Atlantic coast and Southeastern states. (E. 88-89). About 65% of Commonwealth's production which is sold in Maryland is distributed at retail through its own company-operated stations; the balance is sold at wholesale. (E. 142-43, 462).

First, refining is capital-intensive and refining operations are not efficient unless there is full utilization of plant capacities (E. 487, 509). Since independents do not control an assured source of crude oil for their refineries, they are subject to periodic supply interruptions. When this occurs, production declines and per unit costs increase (E. 487-88).

Second, lack of a controlled crude supply makes independent refiners vulnerable to fluctuations in the cost of their raw materials. The independents must both purchase their crude oil from uncontrolled sources at prevailing market prices and sell refined products in the wholesale market to customers over whom they have no control. This means that increases in crude prices rapidly affect independents' market position by driving wholesale prices above the prices posted by competitors that have access to controlled sources of lower cost supply. When this happens the independents must either absorb the added crude costs, with lessened profitability, or attempt to recover the increased costs from their customers and risk the loss of wholesale business. (E. 489-90).[6]

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[6]These characteristics caused extreme difficulties for independent refiners during the fuels crisis of 1973-74, when shortages of crude supplies and escalating world crude prices placed independents at a severe competitive disadvantage compared to the major oil companies. The result was an inability to supply wholesale customers at competitive prices. In Ashland's case, this produced a sudden loss of wholesale customers, who defected to other suppliers. (E. 489-90, 496-97). If Ashland had not been able to continue marketing gasoline through its own retail outlets, it would have been obliged to reduce refinery runs which [illegible] would have impaired the profitability of its business. (E. 490). The federal government responded to the fuels crisis by passage of the Emergency Petroleum Allocation Act of 1973, 15 U.S.C. §§751 *et seq.*, which provides for allocation of energy supplies to compensate for the crude cost disadvantages suffered by the independents. (E. 148-84). Section 4(b)(1)(D) and (F) of the Act reflects an express Congressional recognition that the program mandated by the Act was designed in part

(continued)

The response of independent refiners to these problems has been to seek assured outlets for their products so as to maintain continuous production volume. (E. 490). The major oil companies achieve the same objective by establishing a network of retail dealers, who typically lease their stations from the refiner and who purchase its production for resale at branded outlets. (E. 505). A system of this sort is not feasible for independent refiners because it can work only if the dealers can offer a recognized brand of gasoline; independent refiners simply do not have the financial resources to develop the brand recognition which this form of retail marketing requires. (E. 488-89, 506-07). Consequently, the independents have come increasingly to rely on company-operated stations which sell unbranded gasoline at discount prices.[7] Such stations are relatively easy to establish, since customers are attracted by lower gasoline prices rather than by credit cards, advertising and other promotional activities associated with branded operations. (E. 489).

What is true at the national level is also true in Maryland. Ashland and Commonwealth operate company-owned private brand stations in Maryland because this is the only feasible way for them to do business in this market. (E. 488-89, 492, 579). Both companies also sell gasoline at wholesale; Ashland is one of the principal sources of wholesale supply for the independent marketers who also

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[6](continued)
to preserve the independent refiners as a competitive force in the market during the period of shortages and crude cost dislocations. (E. 577).

[7]Major oil companies may also operate private brand stations, if they choose to do so. For example, Continental Oil Company has no "Conoco" branded outlets in the State, but instead sells exclusively through its 14 company-operated "Kayo" stations. (E. 70-71). The difference is that independents do not have this choice — private brand stations operated with salaried employees are the only form of retailing in which they can engage.

operate private brand stations in the State. (E. 493, 577). As in other areas, Ashland uses its retail outlets to balance wholesale sales, which fluctuate in volume as wholesale prices change. (E. 493). This balance must be maintained in order to operate at all in the State, because Ashland can only supply its Maryland customers by means of exchange agreements with other oil companies that deliver gasoline directly into the State and such agreements cannot be maintained unless both parties are able to exchange products on a regular basis. (*Id.*).

The uncontradicted record evidence shows that the private brand segment of the market provides significant competition to the major brand stations by offering gasoline at discount prices. (E. 387, 397, 454, 491, 499). The record also shows that it is economically infeasible to operate private brand stations with dealers, because dealers will not accept the high-volume, low-margin marketing strategy which is necessary to the success of this form of retailing. (E. 388, 453, 456, 488-89, 499). All the witnesses who testified at trial agreed that companies such as Ashland and Commonwealth could not convert their stations to dealer operations, and would be obliged to withdraw from the State if these stations cannot be operated with company personnel. (E. 388-89, 491, 547). Elimination of these refiner-marketers from the State would not only remove an important source of price competition, but would also further injure the private brand segment of the market by reducing supplies available to independent marketers. (E. 577).[8]

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[8]A further result of the Maryland Act would be to prevent independent marketers from acquiring refineries of their own so as to protect their sources of supply. One such company now operating private brand stations in Maryland, Hudson Oil, indicated it planned to construct a refinery near Houston, Texas, and stated it would be obliged to abandon its Maryland stations if the Act remained in effect. (E. 500).

The record also shows that the Maryland Act would create barriers to entry of new competitors into the Maryland retail market. (E. 400-02, 510). Even major oil companies, such as Exxon, have found it very difficult to enter new territory without using company-operated stations as a starting point in a campaign to establish brand recognition. (E. 359). This economic fact of life has even greater force for the independent refiners, which have no other means of penetrating new markets. Elimination of these potential entrants would thus remove the most likely source of future price competition in the Maryland market. (E. 400-02).

The trial court found that

> among the experts who testified there was unanimous agreement that in precluding independent crude-deficient refiners from selling at retail in Maryland, a powerful source of price competition with the branded dealers would be eliminated, the effect of which would be anti-consumer, and that any law which had such an effect would not be in the interest of the public at large. (App. D 130a).

The State's own expert witness admitted he was "troubled" by the Act's application to independent refiners (E. 552), and agreed this was a "negative" feature of the legislation. (E. 581). Indeed, he stated that if he, as a professional economist, had been called upon to draft the Act he would have excluded independent refiners from the scope of its prohibitions. (E. 555, 582; *see* App. D 119a).

The Court of Appeals noted the State's expert had "conceded that the Act, by excluding certain partially integrated marketers, could in some respects be anti-competitive. . . ." (App. A 15a). However, it found that "the purpose of the statute was to preserve competition within the retail gasoline marketing industry in Maryland" (App. A 19a), and held that "the state's interest, as determined by the

Legislature, outweighs any slight burden which the Act may impose on interstate commerce." (App. A 24a). In doing so, the Court of Appeals ignored the trial court's finding that "the entire bill is designed to benefit one class of merchant to the detriment of another" (App. D 131a), and held instead that the Act's "purpose was not to protect Maryland interests from out-of-state competition." (App. A 19a).

THE QUESTION IS SUBSTANTIAL

The decision below sharply focuses a number of important Commerce Clause problems in a novel factual setting. No decision of this Court has ever considered whether a state may prohibit out-of-state refiners from direct sale of their products within its borders.[9]

Maryland has decreed that refiners operating in interstate commerce may not sell motor vehicle fuels directly to consumers, but must distribute their products, if at all, through retail service station dealers. It has thereby reserved a substantial segment of the retail trade in motor vehicle fuels to local dealers, to the exclusion of their lower priced out-of-state competitors. This result has been approved under the Commerce Clause by the Maryland Court of Appeals despite its own admission that a number of refiners now operating in the State "market exclusively through company-operated stations" and "might be forced to withdraw from the Maryland market if the Act were to become effective." (App. A 23a). The question before this Court is whether the Constitution can tolerate state legislation which has such drastic effects on interstate businesses.

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[9]The one decision that the Maryland court thought to be in point, *Crescent Cotton Oil Co. v. Mississippi*, 257 U.S. 129 (1921), involved the cotton ginning industry in an era long predating this Court's modern development of Commerce Clause principles. Referring to that decision, the Maryland court merely said it "may be of some significance in determining a state's authority" to regulate commerce. (App. A 21a).

I

THE QUESTION HAS NATIONAL SIGNIFICANCE

The question here presented is not confined to an isolated attempt by a single state to regulate the distribution of petroleum products within its boundaries. Although Maryland was the first state to enact such legislation, similar laws have been considered by thirty-eight other states at various times in the recent past.[10] Delaware, Florida and the District of Columbia have enacted statutes similar to the Maryland Act,[11] and at least eleven other states are currently considering such legislation.[12] There is thus a nation-wide movement at the state level to restructure distribution patterns in the petroleum industry.[13]

The potential disruption which this movement could produce was recently underscored by a representative of the Federal Trade Commission:

> One problem is that several states — Maryland is a prime example — have enacted so-called marketing divestiture laws which do not require the sale of station premises, but do preclude

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[10]Statement of Owen M. Johnson, Jr., Director, Bureau of Competition, Federal Trade Commission, commenting on H.R. 130 and related bills, before the Subcommittee on Energy Conservation and Regulation of the Senate Committee on Energy and Natural Resources, May 25, 1977, p. 8.

[11]See Fla. Stat. Ann. §526.151 (Supp. 1974); Del. Code Ann. §§2905-2906 (1976 Cum. Supp.); D.C. Law 1-123 (Council of the District of Columbia, April 19, 1977). The Florida statute was declared unconstitutional by a state trial court in *Exxon Corp. v. Conner*, Case No. 74-1449 (Cir. Ct., 2d Jud. Cir., Leon County, January 25, 1975); that decision was not appealed. The Delaware statute is currently being challenged in the courts of that state.

[12]Rhode Island, Massachusetts, New Hampshire, New Jersey, Maine, Washington, Oregon, New York, Illinois, North Carolina and Connecticut.

[13]See Note, *Gasoline Marketing Divestiture Statutes: A Preliminary Constitutional and Economic Assessment*, 28 Vand. L. Rev. 1277, 1279 (1975).

> direct operation of outlets by the refiners. Pushed through the legislatures by the franchised dealers, such legislation has sometimes had the practical effect of eliminating from state markets the non-branded dealers. These price-competitive retail outlets have generally been directly operated by employees of independent refiners. By failing to exempt these smaller refiners, who believe they cannot operate efficiently through a franchise system, these laws are apparently eliminating the very price cutters who most benefit consumers. This is a serious new development which merits Congressional concern.[14]

It is obvious that only Congress could adopt uniform regulations to govern petroleum marketing, if any such regulations are needed. It is equally obvious that other states will be encouraged to follow Maryland's lead if the decision of the Maryland Court of Appeals is allowed to stand. Indeed, this is already happening. Only last month, the Supreme Court of New Hampshire advised the state legislature that a proposed bill similar to the Maryland Act was immune from any Commerce Clause objections. *Opinion of the Justices* (No. 7804, June 20, 1977). In rendering that advice, the justices relied heavily upon the "comprehensive, well-reasoned opinion [of] the Court of Appeals of Maryland." It has also been reported that Rhode Island franchised dealers, encouraged by the Maryland decision, are "pushing their own divorcement bill to bar company-operated stations . . . which has passed the state senate by a vote of 40 to 1." *Wall Street Journal*, June 16, 1977, p. 26.

It is apparent that a whole series of questionable state burdens on interstate commerce are likely to follow in the wake of the Maryland court's decision. These state statutes are unlikely to be uniform either in their scope or in their terms. A process of this sort, once begun, will inevitably

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[14] *Op. cit. supra* note 10, pp. 8-9.

lead to a patchwork quilt of contradictory regulations which will seriously disrupt the economic organization of a vital national industry.[15]

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[15]Since the inception of severe energy shortages and escalating petroleum prices in 1973, Congress has been actively reviewing the complex structure of the petroleum industry to determine whether federal legislation is needed in this field. In the 94th Congress, the Senate enacted S. 323, which would have limited the ability of major market shareholders to increase the number of their company-operated retail outlets. S. 323 exempted independent refiners such as Ashland and Commonwealth from the definition of "major market shareholders." Also in the 94th Congress, the House of Representatives considered H.R. 13000, which would either have declared a two-year moratorium on openings of refiner-operated retail outlets or have imposed an elaborate system of functional accounting to identify profits earned by different branches of integrated companies.

None of these proposals was enacted, due in part to the opposition of the Federal Trade Commission and the Federal Energy Administration. See House Report No. 94-1615, September 18, 1976. The FEA noted, for example, that

> FEA opposes a marketing moratorium which would restrict either the gasoline volume or the total number of refiner operated retail outlets. Any such moratorium would seriously interfere with competition in the marketplace and would encourage continuance of some inefficient operations. . . .
>
> Applying the lessons we have learned from over two years of price and allocation controls we find that, unfortunately, there are no easy solutions. Legislation designed to specifically prohibit unfair pricing practices often results in either restricting competition or the ability of a franchisor to expand his business to whatever extent market conditions might allow. *Id.*, p. 36.

The current Congress is considering similar proposals. S. 323 has been reintroduced as S. 19 by Senator McIntyre, again with an exemption for independent refiners. Senator Durkin has introduced S. 743, which pursues the concept of functional pricing contained in H.R. 13000. Hearings were held on both proposals on May 25, 1977, by the Subcommittee on Energy Conservation and Regulation of the Senate Committee on Energy and Natural Resources.

The extent, if any, to which the states may regulate the interstate distribution of petroleum products is a matter which only this Court can decide. The importance of that question to the national economy merits plenary review.

II

THE DECISION BELOW RAISES IMPORTANT ISSUES RESPECTING THE CONSTRUCTION AND APPLICATION OF THE COMMERCE CLAUSE

The Maryland Court of Appeals held that the State's ban on operation of service stations by refiners constitutes neither a burden on the free flow of petroleum products into Maryland nor a discrimination against the interstate activities of the independent refiners. (App. 18a-24a). The rationale for that holding poses substantial Commerce Clause questions which warrant this Court's full review.

A. The Maryland Act Imposes A Significant Burden on Interstate Commerce.

The court below found that the Maryland Act does not violate the Commerce Clause because it "merely regulates a wholly intrastate activity, the retail marketing of gasoline within the state." (App. A 18a).

This finding assumes that retailing can be classified as a "wholly intrastate activity," regardless of the character of the retailers' customers and the sources from which their supplies are derived. In determining whether a commercial process affects interstate commerce, this Court considers such factors as whether the products sold move across state lines and whether the purchasers are involved in interstate

activities. *Daniel v. Paul*, 395 U.S. 298 (1969); *Katzenbach v. McClung*, 379 U.S. 294 (1964). The Maryland court's facile conclusion that gasoline retailing is an intrastate activity stands in marked contrast to these recent decisions; it is also directly contradicted by this Court's conclusion that the sale of gasoline is not an intrastate activity exempt from regulation under the federal anti-trust laws. *F.T.C. v. Sun Oil Co.*, 371 U.S. 505 (1963); *Standard Oil Co. v. F.T.C.*, 340 U.S. 231 (1951).

The court also found that the Maryland Act does not restrict the free flow of petroleum products into the State, because refiners would "still remain free to import and sell petroleum products to wholesalers and retail service station dealers" (App. A 18a), and interstate travellers could purchase their full requirements from these classes of retailers. (App. A 23a). The Maryland court thus appears to believe that no regulation of business activity, however severe, can constitute a burden on commerce if the total amount of product sold in the state is not reduced.

This Court, however, has made it clear that commerce may be burdened in ways more subtle than by simple prohibition of imports. Regulations which increase operating costs, impair efficiency, and hamper the competitive position of participants in interstate commerce may also offend the Commerce Clause. *Great Atlantic & Pacific Tea Co. v. Cottrell*, 424 U.S. 366 (1976), *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 144 (1970); *H.P. Hood & Sons v. DuMond*, 336 U.S. 525, 539 (1949); *Southern Pacific Co. v. Arizona*, 325 U.S. 761, 781-82 (1945). The "common thread" of these decisions is that a state may not interfere "with the natural functioning of the interstate market either through prohibition or through burdensome regulation." *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 806 (1976).

The record shows that independent refiners who trade exclusively through company-operated stations would be

forced to withdraw from the State if the Maryland Act becomes effective. The Maryland court chose to disregard this evidence because some of the company witnesses had indicated "that no firm decision had been made to withdraw if the Act were to become effective, and that it still might be possible to distribute products in Maryland." (App. A 23a).[16] But the bare possibility of continued operations is not dispositive, because the record demonstrates that the added costs of compliance with the Maryland Act would severely limit the ability of independent refiners to compete with branded retail dealers. The Act's requirements thus place a burden on independent refiner-marketers which would disrupt the "natural functioning of the interstate market."

This Court, not the Maryland court, has the ultimate responsibility to decide whether a particular state regulation constitutes a permissible burden on interstate commerce. *Morgan v. Virginia*, 328 U.S. 373, 380 (1946). We submit that the mechanistic approach of the Maryland court does not resolve that issue.

B. The Maryland Act Discriminates Against Interstate Commerce

The Court of Appeals also found that the Maryland Act "does not in effect discriminate against out-of-state interests as opposed to local interests" (App. A 19a), because "out-of-state and Maryland retailers are treated the same." (App. A 20a). This is a strange conclusion in view of the Act's express requirement that all refiner-owned stations "must be operated by a retail service station dealer."

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[16] What the witnesses actually said was that the question of withdrawal had not yet been decided by the companies' boards of directors. (E. 390, 461). However, their testimony makes clear that continued operations would be extremely doubtful under the Maryland Act because these companies could not maintain their competitive position if they were required to operate their stations with dealers. (E. 457, 492).

As recently as last month, this Court found it "somewhat suspect" that the demands of the local apple growers had been mainly responsible for labelling regulations which singled out containers by which apples were transported in interstate commerce. *Hunt v. Washington State Apple Advertising Commission*, ____ U.S. ____, 45 U.S. Law Week 4746, 4751 (No. 76-63, June 20, 1977). The same suspicion is warranted here with respect to a statute which applies only to out-of-state refiners, which benefits only local dealers, and which was enacted with the active support of local dealer organizations. (App. A 9a).[17] These facts, coupled with the Act's express provisions, demonstrate one of the "rare instances where a state artlessly discloses an avowed purpose to discriminate against interstate goods." *Dean Milk Co. v. City of Madison*, 340 U.S. 349, 354 (1951).

It is, of course, axiomatic that a discrimination against commerce may exist even when the regulation is not discriminatory on its face. *Nippert v. City of Richmond*, 327 U.S. 416, 431 (1946). See also *Dean Milk Co. v. City of Madison, supra*, 340 U.S. at 354 n. 4; *Brimmer v. Rebman*, 138 U.S. 78, 82-83 (1891). Although the Maryland Act treats all refiner-marketers the same, it does so by excluding them from retail trade within the State. The practical effect of this treatment is to shield local major brand station dealers from competition with an entire class of competitors that sell private-brand gasoline at discount

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[17] See Note, *Gasoline Marketing Divestiture Statutes: A Preliminary Constitutional and Economic Assessment*, *supra* at 1307, which observes that statutes of this type

> . . . will unquestionably have the effect of shielding local gasoline dealers from the competition of . . . producers engaged in interstate commerce. Whatever the enacting states' asserted interest in insuring motorist-consumers an uninterrupted supply of reasonably-priced petroleum products, the independent dealers' lobbyist groups have supplied the primary impetus for the enactment of the divestiture statutes.

prices. Such discrimination, which interferes with the federal interest in guaranteeing "free access to every market in the Nation," *H.P. Hood & Sons v. DuMond, supra.* 336 U.S. at 539, violates the Commerce Clause whether or not the purpose to do so appears on the face of the statute. See *Great Atlantic & Pacific Tea Co. v. Cottrell.* 424 U.S. 366 (1976); *Polar Ice Cream & Creamery Co. v. Andrews.* 375 U.S. 361 (1964); *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511 (1935).

C. The Discriminatory Burdens Imposed By The Maryland Act Cannot Be Justified By Any Legitimate Local Interest.

Although the Court of Appeals denied that the Act burdened commerce, it also found that "the state's interest, as determined by the Legislature, outweighs any slight burden which the Act may impose on interstate commerce." (App. A 24a). The state interest identified by the Maryland court was the Legislature's desire to preserve competition by preventing control of the retail market "by a few major oil companies." (App. A 19a).[18]

When a discrimination against interstate commerce has been demonstrated, "the burden falls on the State to justify it both in terms of the local benefits flowing from the statute and the unavailability of non-discriminatory alternatives, adequate to preserve the local interests at stake."

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[18]Although hearings were held on the legislation, no transcript was made and no legislative findings were issued. It is thus not possible to determine with any certainty what the Legislature intended to accomplish when it adopted the Act. The "legislative history" consists almost entirely of testimony concerning surveys performed by the Gasoline Tax Division at the request of the Governor to determine whether the 1973 gasoline shortage was "real or contrived." (App. A 7a-8a). The witnesses who presented that testimony admitted at the trial that none of the facts gathered in the surveys had any relevance to Paragraphs (B) and (C) of the Act. (E. 534, 547).

Hunt v. Washington State Apple Advertising Commission, supra, 45 U.S. Law Week at 4751. See also *Great Atlantic & Pacific Tea Co. v. Cottrell, supra*, 427 U.S. at 371-72; *Pike v. Bruce Church, Inc., supra*, 397 U.S. at 142; *Dean Milk Co. v. City of Madison, supra*, 340 U.S. at 354. This burden is especially great when the interest asserted is unrelated to the protection of health and safety, because promotion of local economic interests is permissible only if there is no undue discrimination against out-of-state interests. *H.P. Hood & Sons v. DuMond, supra*, 336 U.S. at 531-32.

The Court of Appeals made no serious effort to balance the competing local and interstate interests because it erroneously concluded that the Maryland Act did not impose a substantial burden on interstate commerce. Had it performed the balancing process which this Court's precedents require, the Maryland court would have been obliged to consider whether retail stations operated by independent refiners pose a threat to competition. The trial court found that retail stations operated by independent refiners were "a powerful source of price competition with the branded dealers" and that their elimination from the marketplace would be "anti-consumer." (App. D 130a). The trial court also found that "[t]here was no proven detrimental effect upon the retail market caused by company-owned-and-operated stations which could not be curbed by federal and state anti-trust laws" (App. D 131a). The Court of Appeals ignored both of these findings.

The Maryland court's analysis of the Commerce Clause issue reflects an assumption that the Legislature's judgment respecting the need to order divestiture of company-operated retail stations could not be questioned if the Legislature reasonably believed the measure might be necessary. (App. A 19a, 24a). This assumption is wrong as a matter of law. *Cf. City of New Orleans v. Dukes*, 427 U.S. 297, 304 n. 5 (1976). However, even if it were correct, there is no rational connection in fact between the retail activities

of companies such as Ashland and Commonwealth and the supposed "evils" which the court said the Legislature wished to prevent.

These evils, as outlined by the Court of Appeals, were alleged discriminations in supply as between company-operated and dealer-operated stations during the 1973 fuel crisis,[19] and reported plans of some companies to increase the number of company-operated stations at the expense of dealers. (App. A 19a). Whatever the merits of these objectives as applied to companies which market primarily through franchised dealers, the requirement that companies such as Ashland and Commonwealth must cease to operate retail service stations clearly cannot be justified as a legitimate dealer-protection measure.[20]

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[19]The trial court found that the State had failed to produce any evidence to show that any company had discriminated against dealers in allocating supplies during the crisis period. (App. D 131a). The Court of Appeals did not disturb this finding; it simply ignored it.

[20]The notion that such protection is required to protect branded dealers from "unfair" competition by refiner-operated stations was recently contradicted by a representative of the Federal Energy Administration:

> As a logical result of higher gasoline prices, consumers are becoming increasingly price sensitive. Consumers are also beginning to realize that a brand name makes little difference in how a given grade of gasoline performs in their cars. This has eroded the market position of some branded dealers, the majority of whom are franchisees . . . .
>
> * * *
>
> While there are numerous allegations concerning refiners using profits from crude oil production to subsidize retail operations, we have been unable to amass substantial evidence that this is taking place on a scale that would threaten the competitive viability of branded independent dealers or any other segment of the gasoline retailing business. As pointed out earlier, branded independent dealers still sell over 71 percent of the gasoline sold through

(continued)

Ashland and Commonwealth do not operate through dealers in Maryland, and have never done so. They have no dealers to terminate, convert to company-owned stations, discriminate against with respect to supplies, or otherwise treat unfairly. They also lack the resources to compete unfairly with independent marketers, as the State's own expert witness acknowledged. (E. 580). The only consequence of the Act, as applied to Ashland and Commonwealth, would be to eliminate an important source of price competition in the marketplace. This would not promote competition, as the Court of Appeals implied, but would weaken it to the ultimate detriment of the consumer.

"[T]he very purpose of the Commerce Clause was to create an area of free trade among the several States." *Boston Stock Exchange v. State Tax Commission*, ____ U.S. ____, 97 S.Ct. 599, 606 (1977). The unjustified exclusion of independent refiners from the Maryland retail market flies in the face of that fundamental proposition.

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[20](continued)

service stations, and their market share has been essentially stable over the past year . . . .

* * *

With respect to S.19 specifically, the FEA opposes the marketing restrictions on refiner/marketers as outlined in Section 5 of that Bill. A restriction on the number of refiner operated retail outlets would seriously interfere with competition in the marketplace and would encourage continuance of some inefficient operations.

Statement of Gorman C. Smith, Acting Deputy Director, Federal Energy Administration, commenting on H.R. 130 and related bills, before the Subcommittee on Energy Conservation and Regulation of the Senate Committee on Energy and Natural Resources, May 25, 1977, pp. 4, 9, 12.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the question presented by this appeal is so substantial as to require plenary consideration, with briefs on the merits and oral argument.

Respectfully submitted.

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July 11, 1977

APPENDIX

IN THE COURT OF APPEALS
OF MARYLAND
September Term, 1976

No. 10

GOVERNOR OF THE STATE OF
MARYLAND, ET AL.,
Appellants

v.

EXXON CORPORATION, ET AL.,
Appellees

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

Notice is hereby given that Petroleum Marketing Corporation and Commonwealth Oil Refining Company, Inc., appellees in the above-captioned action, hereby appeal to the Supreme Court of the United States from the final judgment of this Court, reversing the judgment of the Circuit Court for Anne Arundel County and upholding Chapter 854, Laws of Maryland 1974, as amended by Chapter 608, Laws of Maryland 1975 (the "Act"). The appeal is from that part of the decision applying to Paragraphs B and C of the Act. The judgment of the Court of Appeals of Maryland was entered on February 18, 1977, and appellees' motion for reconsideration was denied on April 13, 1977.

This appeal is taken pursuant to 28 U.S.C. §1257(2).

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Filed: July 11, 1977

IN THE CIRCUIT COURT
FOR ANNE ARUNDEL COUNTY

PETROLEUM MARKETING CORPORATION
AND COMMONWEALTH OIL REFINING
COMPANY, INC.,
Plaintiffs

v. EQUITY NO. 22,551

MARVIN MANDEL, Governor
et al.,
Defendants

NOTICE OF APPEAL TO THE
SUPREME COURT OF THE UNITED STATES

Notice is hereby given that Petroleum Marketing Corporation and Commonwealth Oil Refining Company, Inc., plaintiffs in the above-captioned action hereby appeal to the Supreme Court of the United States from the decision of the Court of Appeals of Maryland entered on February 18, 1977 reversing the decision of this Court and remanding the case for entry of a judgment in accordance with its opinion, which decision became final upon the filing of a supplementary opinion by the Maryland Court of Appeals on April 13, 1977 denying plaintiffs' motion for reconsideration. The appeal is from that part of the decision applying to Paragraphs B and C of Chapter 854, Laws of Maryland 1974, as amended by Chapter 608, Laws of Maryland 1975.

Pursuant to Rule 877 of the Maryland Rules of Procedure, the record in these actions is in the possession of this Court.

This appeal is taken pursuant to 28 U.S.C. §1257(2).

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Filed: July 11, 1977